THE FEDERAL FARM LOAN ACT

The passage of a land credit measure by the federal government has at last been accomplished. On July 17, 1916, President Wilson approved the Federal Farm Loan bill, thereby settling for a time a question that has given rise to no small amount of legislative interest. During the past four years repeated attempts have been made to discover a practical formula for constructive land credit legislation. The merits of various programs have been carefully estimated and discussed. Now that the mystery surrounding one of the problems of agricultural finance has been definitely cleared, and a program of reform finally adopted, it is expected that the long-term credit facilities of farmers will be improved in no less degree than the Federal Reserve act improved the machinery for granting loans to the commercial classes. Incidentally, the new law marks the fulfilment of a party platform pledge, a pledge that was accepted and ardently supported by the President during his candidacy.

I

The steps leading up to the enactment of this important piece of legislation may be briefly noted. The Country Life Commission, created in 1908, found that among the causes contributing to the deficiencies of country life was the "lack of any adequate system of agricultural credit whereby the farmer may readily secure loans on fair terms,"[1] and suggested that "a method of coöperative credit would undoubtedly prove of great service."[2] This view was favorably received by those who saw in the rural problem an economic cause—who believed that the conditions of country life could be made more attractive only by the adoption of a program that would promote the prosperity of the agricultural worker. Further support was given to this point of view by the report of the National Monetary Commission which contained a stimulating account of the German *landschaft* system.

Public interest in the possibilities of coöperative credit was immediately aroused. Investigations of European systems were undertaken not only by prominent organizations like the American Bankers' Association, but also—at the instance of President

[1] Sen. Doc. No. 705, 60 Cong., 2 Sess., p. 15.

[2] *Ibid.*, p. 59.

Taft who had become convinced of the need and feasibility of a system of coöperative credit[3]—by the American diplomatic representatives in certain European countries. Subsequently, the desire to study at first hand and to popularize the methods employed by coöperative credit and coöperative marketing organizations led the Southern Commercial Congress to assemble the American Commission. And, finally, it is especially noteworthy that the United States Commission was appointed not for the purpose of inquiring into European or Australian systems of state loans but rather "to investigate and study in European countries *coöperative* land-mortgage banks, *coöperative* rural credit unions, and similar organizations and institutions devoting their attention to the promotion of agriculture and the betterment of rural conditions."[4]

Thus the movement for rural credit reform had its origin in a larger movement which sought to improve agricultural conditions through the application of coöperative principles to the business of farming. But it soon became an independent issue, receiving the unqualified indorsement of the three political parties in the national conventions of 1912. The realization had suddenly dawned upon the American people that the commercial banking system on which the farmer was dependent was ill-adapted to his needs, that he lacked the financial machinery enjoyed by other classes of borrowers, and that his rate of interest was higher than the rate paid by industrial corporations, railroads, and municipalities. However unfair such a comparison may seem, it nevertheless evoked widespread complaint and created an urgent demand for the adoption of some scheme, coöperative or otherwise, that would greatly reduce the farmer's rate of interest.

The report of the United States Commission had an important bearing on the course of subsequent events. That report was confined to a consideration of rural credit. The general conclusions reached by the commission as a result of its European investigations were that the same institution could not properly supply the farmer's long-term and short-term credit requirements, that reform in the long-term facilities should come first, and that with the establishment of suitable machinery under strict federal supervision private initiative could be depended upon to reduce the farmer's rate of interest and improve the methods of making

[3] See *Preliminary Report on Land and Agricultural Credit in Europe*, Sen. Doc. No. 967, 62 Cong., 3 Sess., pp. 3-7.

[4] Sen. Doc. No. 380, 63 Cong., 2 Sess., p. 3. Italics are the author's.

loans.[5] Although the commission recognized the "value of co-operative effort and the wisdom of permitting coöperative institutions to be organized," it found that the *landschaft* form was unsuited to the conditions and requirements of American agriculture.[6] Furthermore, it recorded its firm conviction "that not only was government aid unnecessary, but that it would be unwise."[7]

The Moss-Fletcher bill,[8] one of the early rural credit bills to be introduced, embodied the specific recommendations of the commission. It provided for the voluntary organization of decentralized farm-land banks under a federal charter with power to issue bonds on the collective security of farm mortgages. The minimum amount of capital required for the organization of a single bank was $10,000, and the territory within which it could operate was limited to the area of a state. Numerous other restrictions and conditions not entirely inconsistent with the encouragement of private initiative were imposed for the purpose of making the bonds attractive to investors. It is sufficient to note, however, that the bill was generally regarded with suspicion. The charge was persistently made that it placed too much reliance on private initiative, that it was a banker's rather than a farmer's measure, that it would not only lead to unnecessary centralization in banking power but would also fail to afford the needed relief to the debtor farmer. Moreover, in the course of the extensive hearings that were held it was found that the framers of the bill were not wholly agreed as to the wisdom of its provisions; and that the Bathrick bill,[9] which provided for direct government loans at a low rate of interest, had the stronger support of the farmers' organizations.

Accordingly, the bill was withdrawn and a more drastic measure known as the Hollis-Bulkley bill[10] was drafted and introduced by

[5] Sen. Doc. No. 380, 63 Cong., 2 Sess., p. 3.

[6] *Ibid.*, p. 31.

[7] *Ibid.*

[8] H. R. 12585, 63 Cong., 2 Sess., introduced Jan. 29, 1914. S. 2909, previously introduced by Senator Fletcher, was withdrawn.

[9] H. R. 11897, 63 Cong., 2 Sess., introduced Jan. 19, 1914.

[10] H. R. 16478, 63 Cong., 2 Sess., introduced May 12, 1914. This bill formed the basis of the present law. It provided for the appointment of a farm loan commissioner by the Federal Reserve Board to supervise the organization and management of national farm loan associations. These associations could be formed under a federal charter with a capital stock of not less than $10,000, to be subscribed, if the board of directors so authorized, after the manner

the chairmen of the subcommittees. This measure was evidently designed to meet the objections that had been urged against the Moss-Fletcher bill. It was far from being a banker's bill as it carefully removed all possibility of private gain; and the federal assistance for which it provided should have satisfied those who favored a program of government loans. But its paternalistic guise failed to win the enthusiastic support of the administration and, as Congress was busily engaged on other pressing matters, all attempts to enact a rural credit law were temporarily abandoned.

At length when the Agricultural Appropriation bill came up for consideration in the House, Representative Bulkley, in a last desperate effort to save the Hollis-Bulkley bill, proposed it as an amendment. In this attempt he was partly successful as the amendment passed the House March 1, 1915. Meanwhile, the McCumber amendment,[11] also proposed as a rider on the Agri-

followed by building and loan associations. When fully organized, they could make long-term loans to farmers up to 50 per cent of the value of their land and 25 per cent of the value of farm buildings at a rate of interest not exceeding the legal rate current in the state where the association was located. Borrowers were required to subscribe for stock in an association up to 5 per cent of the amount of their loans and to reside upon the land offered as security. No association could lend to a single borrower more than $4,000, nor a larger sum than 25 per cent of its capital and surplus.

The bill authorized the Federal Reserve Board to divide the country into twelve districts, the boundaries of which corresponded so far as possible with state boundary lines, and to establish in each district a federal land bank having a capital stock of $500,000. National farm loan associations were required to subscribe at least 10 per cent of their capital to the capital of the land bank located in their district. If their subscriptions were insufficient to provide the land banks with the required capital, the Secretary of the Treasury was authorized to subscribe for the balance.

Federal land banks were to have power to purchase first farm mortgages from the national farm loan associations within their respective districts and, under certain conditions, from institutions organized under state laws. On the security of these mortgages they could issue bonds, bearing an interest rate of 5 per cent or less, to an amount equal to twenty times their capital and surplus. The bonds were to be exempt from all taxation and were made legal investments for the funds withdrawn from postal savings depositaries if the bonds could be purchased at par or below. Finally, upon the recommendation of the Federal Reserve Board, the Secretary of the Treasury might be required to purchase land bank bonds to an amount not exceeding $50,000,000 in any one year. No less administrative authority was given to the Federal Reserve Board than that conferred by the Federal Reserve act of 1913.

[11] Subsequently introduced as S. 831, 64 Cong., 1 Sess.

cultural Appropriation bill, had passed the Senate February 25, 1915. This measure provided for the establishment of a bureau in the Treasury Department with power to issue bonds and to purchase farm mortgages from state and national banks so long as its bonds could be disposed of at par. No objection was made to the amendment by the supporters of the Hollis-Bulkley bill because they expected the latter to be adopted in conference.[12] But owing to a lack of time for proper consideration, the two riders were stricken out and replaced by a clause authorizing the formation of a joint committee of twelve members of the Senate and House to prepare and report to Congress on or before January 1, 1916, a bill or bills providing for the establishment of a system of rural credits adapted to American needs and conditions. This action was approved March 4, 1915, and the joint committee was immediately organized.

On January 3, 1916, the Joint Committee on Rural Credits submitted the report[13] of its subcommittee on land-mortgage loans together with the draft of a proposed bill[14] which differed but slightly from the Hollis-Bulkley bill. It was introduced two days later by Senator Hollis, was favorably reported by the Senate Committee on Banking and Currency with amendments[15] February 15, and passed the Senate with scarcely any opposition May 4. The same bill somewhat changed passed the House May 15 and, as has been indicated, is now a federal law.[16]

II

It would be beyond the scope of the present discussion to deal with any but the fundamental provisions of the new law. As a piece of legislation it is exceedingly complicated and far more experimental than the Federal Reserve act from which its inspiration was originally drawn. That measure was intended to reform a commercial banking system already in existence, while the Fed-

[12] According to a personal letter from Senator Henry F. Hollis. See *Congressional Record,* vol. 52, pp. 5195-5196.

[13] Printed as House Doc. No. 494, 64 Cong., 1 Sess.

[14] S. 2986, known as the Hollis bill or the Federal Farm Loan bill.

[15] Sen. Rep. No. 144, 64 Cong., 1 Sess.

[16] So many changes were made in the Federal Farm Loan bill as amended by the Senate Committee on Banking and Currency that it will be impossible to note them in this article. Most of the important changes were made by the House. For a comparative print of the bill showing the changes made in both houses, see Sen. Doc. 444, 64 Cong., 1 Sess.

eral Farm Loan act contemplates the establishment of an indefinite number of new institutions to supplement, if not to supplant, the numerous agencies now engaged in the business of making farm loans. Moreover, in recognition of the experimental nature of any one plan of reform, and in view of the conflicting notions as to which plan should be followed, provision is made for the employment of three distinct programs so that by one means if not by another the law may succeed in accomplishing the definite purpose for which it was enacted.

In the first place, it provides for the creation of a Federal Farm Loan Bureau in the Department of the Treasury under the immediate supervision of a Federal Farm Loan Board consisting of the Secretary of the Treasury and four other members to be appointed by the President. As soon as practicable after the members of the board have been appointed, they are authorized to divide the country into twelve districts, no one of which may contain a fractional part of any state, and to establish in each district a federal land bank having a capital stock of not less than $750,000. Shares will be issued in convenient denominations of $5, and may be purchased by individuals, firms, corporations, and the state or federal governments. In case any part of the required capital remains unsubscribed thirty days after the opening of the subscription books, the Secretary of the Treasury is authorized to subscribe for the balance. Provision is made, however, for the gradual retirement of the stock held by the United States as soon as subscriptions from other sources are found to be adequate.

Beneath this superstructure, the law contemplates the formation of national farm loan associations. These may be formed in any federal land bank district, subject to the approval of the Federal Farm Loan Board and the land bank directors, by ten or more natural persons who are the owners or are about to become the owners of land qualified as security for mortgage loans, and who desire loans in the aggregate of not less than $20,000. An association thus formed must invest 5 per cent of the amount of each loan in the stock of the federal land bank within its district. Its management will be in the hands of a board of five directors who together with all officers except the secretary-treasurer will serve without compensation unless the payment of salaries is approved by the Federal Farm Loan Board. Only borrowers can become members and while no limit is placed on the number of shares that one might own in his association, no more than twenty votes may be cast by a single shareholder.

After an association has received its charter from the Federal Farm Loan Board, it can make long-term loans within its district up to 50 per cent of the value of farm lands and 20 per cent of the value of improvements at a rate of interest, including commissions, not exceeding 6 per cent. Such loans may be made only for the following purposes: (1) to provide for the purchase of land for agricultural purposes; (2) to provide "equipment" and "improvements" as defined by the Federal Farm Loan Board; and (3) to liquidate mortgage indebtedness existing at the time when the first national farm loan association is organized in or for the county containing the mortgaged land. The borrower is required to subscribe for stock in his association[17] up to 5 per cent of the amount of his loan, to cultivate the land offered as security, and to repay the principal in annual or semi-annual instalments. After a loan has been in force for a period of five years, additional payments of $25 or any multiple may be made toward the extinguishment of the principal on regular instalment dates. The longest term for which a loan may run is forty years, and the size of individual loans may vary from $100 to $10,000.

On the security of the mortgages purchased from and indorsed by the national farm loan associations of its district, each land bank is empowered to issue an equal amount of farm loan bonds, bearing an interest rate not to exceed 5 per cent, up to twenty times its capital and surplus. These may be delivered to the farm loan associations or, at the option of the borrower, they may be sold by the land bank for his benefit. In any case he pays the rate of interest borne by the bonds plus an administrative charge which can not exceed 1 per cent of the unpaid principal of his loan. In addition, he will pay, as at present, the cost of appraising the land and perfecting the title, together with the legal fees imposed by his state for recording the mortgage, etc.

It is on the formation of national farm loan associations that the internal organization of the land banks is dependent. Until the stock subscriptions of the associations in a federal land bank district have amounted to $100,000, the officers and directors of the district land bank are to be appointed by the Federal Farm Loan Board. Thereafter, the board of directors will consist of nine members, six of whom, known as local directors, will be chosen by and be representative of national farm loan associa-

[17] Stock held by borrowers, as well as the federal land bank stock purchased by national farm loan associations, will be retired upon full payment of loans.

tions. The remaining three, known as district directors, will be appointed by the Federal Farm Loan Board to represent the public interest. No director in a federal land bank may have any official connection with any other institution engaged in the business of banking or in the negotiation of land-mortgage loans.

Some doubt was evidently in the minds of the framers of the law as to whether national farm loan associations would be immediately formed or, if formed, whether they would be sufficiently numerous to reach the great mass of borrowers. Since the land bank system is designed for and largely dependent on the formation of national farm loan associations, the failure on the part of borrowers to form the local organizations might defeat the purpose for which the land banks were established. In anticipation of this contingency the law provides that if within one year after its passage associations have not been formed in a given locality and are not likely to be formed, the Federal Farm Loan Board may in its discretion appoint banks, trust companies, mortgage companies, or savings institutions incorporated under state laws as agents through which federal land banks can make farm loans subject to the same conditions as if they were made through national farm loan associations. Such agents are empowered to negotiate mortgage loans so long as the aggregate of the unpaid principal of their outstanding loans does not exceed ten times their capital and surplus, or until the district in which they are authorized to operate is adequately served by national farm loan associations. In the meantime they will be held liable for the payment of the mortgages they have negotiated and will receive a small commission for their services.

In order to give further protection to the farm mortgage companies already in existence and to make room for private enterprise in the new system, a third possible source of land credit is contemplated. It is provided that any ten or more natural persons may form a joint-stock land bank, under a federal charter, with power to make land-mortgage loans and to issue farm loan bonds. Such banks must have a capital stock of at least $250,000. They can make mortgage loans and issue bonds under the same conditions and restrictions as imposed on federal land banks with the following exceptions: (1) the territory within which they may operate is limited to the state where the principal office is located and to some one contiguous state; (2) loans may be made on the security of farm land for any purpose and without restriction

as to the amount to be loaned to a single borrower; (3) the borrower is not required to purchase stock or to cultivate the mortgaged land; (4) the rate of interest received on loans or paid on bonds is not subject to alteration or review by the Federal Farm Loan Board;[18] (5) the bonds of joint-stock land banks can be issued only up to fifteen times their capital and surplus; (6) their bonds must be readily distinguishable from the bonds of federal land banks.

The powers conferred upon the Federal Farm Loan Board in the administration of this intricate system are almost unlimited. In addition to those already indicated, the board has the following important powers: (1) to exercise general supervisory authority over federal land banks, national farm loan associations, and joint-stock land banks; (2) to grant or refuse any specific issue of farm loan bonds; (3) to regulate the charges imposed on borrowers for appraisal, determination of title and recording; (4) to alter the rate of interest charged on loans by federal land banks so as to secure as much uniformity in rates as possible; (5) to require federal land banks to coöperate with one another in the payment of interest coupons on federal farm loan bonds; (6) to appoint land bank examiners, land bank appraisers, and a farm loan registrar for each federal land bank district and to fix their compensation; (7) to declare the mortgages on farm lands within a state to be ineligible as a basis for bond issues if after investigation it finds that the laws of that state afford insufficient protection to the holders of first mortgages.

An effort is made to give farm loan bonds a high standing as investment securities. Every series of bonds will be secured by a like amount of first mortgages[19] on farm lands. In the appraisement of land there is little opportunity for collusion. Before any mortgage loan is made by a joint-stock or federal land bank it must first have the approval of local appraisers and the special appraisers of the federal land bank district. Likewise, when a land bank applies for the privilege of issuing bonds, the application must be approved by the proper farm loan registrar with whom the collateral security has been placed in trust. If, after investigation, the Federal Farm Loan Board finds the collateral unsatisfactory, it may reject the application or demand additional security.

[18] See footnote 30.

[19] United States bonds may be substituted.

In the case of bonds issued by federal land banks special security is offered. The bonds of any one of these banks will be secured by the capital, reserves, and earnings of all the federal land banks and by mortgages previously indorsed by agents or by national farm loan associations within its district. Every mortgage so pledged will be further secured by the double liability assumed by borrowers on their stock.[20] And in the event that federal land banks are unable for a time to meet all claims arising on account of the payment of interest coupons and the redemption of bonds, they may rely upon federal assistance. That is, the Secretary of the Treasury is authorized, in his discretion, to deposit government funds with federal land banks and to charge a rate of interest not exceeding the rate current on other government deposits. The aggregate of all sums so deposited may not exceed $6,000,000 at any one time.

In other respects, the bonds of joint-stock and federal land banks will have similar security[21] and will enjoy similar privileges. All first mortgages executed to land banks and all farm loan bonds are to be regarded as "instrumentalities of the government of the United States" and as such will be exempt from all federal, state, municipal, and local taxation. The same exemption applies to the capital, reserve, and surplus of federal land banks and national farm loan associations. Farm loan bonds will be lawful investments for all fiduciary and trust funds and may be accepted as security for all public deposits. They may also be purchased by member banks of the federal reserve system.

Finally, the law provides that the Secretary of the Treasury may designate any land bank, federal or joint-stock, as a depositary of public money, except receipts from customs, and as a financial agent of the government. This feature of the law is not, like that already referred to, intended to afford relief to land banks when temporarily embarrassed because such deposits may not be invested in mortgage loans or farm loan bonds. It is

[20] The law is not clear as to whether those who borrow from agents of federal land banks will be held doubly liable on their stock. See sections 9 and 15.

[21] One possible exception to this statement should be noted. While the law imposes double liability on all stockholders in joint-stock land banks, it makes no attempt to fix the same liability on shares of federal land bank stock purchased by the government or the public, presumably for the reason that these shares will be retired when the subscriptions of national farm loan associations have become sufficient to give the land banks their minimum capital.

merely a skilful manoeuver to aid in establishing the constitutionality of the law.

III

In the evolution of this intricate program the knowledge of European practice has been a confusing element. From the very beginning the merits of coöperation as exemplified in the *landschaft* system received unanimous recognition. But in view of the individualistic nature of the American farmer the successful adaptation of the coöperative form appeared to be impossible. For this reason the United States Commission favored a system of joint-stock banks, patterned somewhat after the joint-stock mortgage banks of Germany, with the provision that they be organized along coöperative lines if desirable; while others, with a less dignified enthusiasm for reform, favored the more expeditious program of direct government loans.

The present law is obviously designed to reconcile these conflicting proposals. It is founded on the strong conviction that coöperation offers not only the most desirable remedy for the problem of agricultural finance but also one that is entirely feasible if supported by federal assistance. Accordingly, liberal aid is provided and the establishment of the federal land bank system is assured. Lest this preliminary organization fail to inspire the development of a coöperative spirit and the formation of national farm loan associations, federal land banks may still be utilized to make loans through existing institutions. Finally, the law endeavors to provide new machinery for the mobilization of land credit at the hands of private initiative. This portion of the law was not contained in the Hollis-Bulkley bill which formed the basis of the present measure. It was incorporated into the final draft of the Hollis bill as reported by the Joint Committee on Rural Credits only at the instance of those committee members who had served on the United States Commission.

Thus the Federal Farm Loan act represents a drastic attempt to solve once and for all the farmer's land credit problem. Its specific purpose is of a three-fold nature, *i.e.*, to improve current methods of granting loans, to reduce the waste growing out of excessive administrative and commission charges, and, so far as possible, to equalize interest rates on land-mortgage loans. This is by no means a small program nor can the full effects of its operation be anticipated. Nevertheless, some of the possibilities inherent in the measure are worthy of careful inspection.

In the first place, the law rightly provides for a longer term of loans and the repayment of the principal by amortization. This provision is in conformity with sound land credit principles. It will obviate a great deal of uncertainty as to the farmer's rate of interest and will literally compel the borrower to save. The privilege accorded to borrowers of repaying the principal of their loans in annual as well as semi-annual instalments is also well taken for the reason that annual payments will be more convenient for those engaged in specialized farming. There is, however, one feature of the amortization plan that does not take account of the peculiarities of the American farmer: namely, the provision that no extra payment can be made toward the extinguishment of the principal until the loan has been in force for a period of five years. While there is some justification on administrative grounds for this restriction, it will undoubtedly deter a great many borrowers from liquidating present loans or from borrowing under long-time contracts. As a class, farmers are especially optimistic. They are accustomed to loans having a maturity of five years and not infrequently they expect to extinguish the whole of their principal before the expiration of that term. Rather than forego the liberal privileges of repayment now accorded by farm mortgage and life insurance companies, some borrowers will prefer to pay a slightly higher rate of interest.

Another feature of the proposed reform which is not likely to make a strong appeal to the average farmer is the requirement that, before loans are granted by federal land banks, the borrower must subscribe for stock in a national farm loan association or, if he borrows through an appointed agent, in the federal land bank itself. Although he may arrange with the federal land bank to advance, as a part of his loan, the price of the stock subscription, the actual cost of appraisal and the determination of the title, together with the legal fees and recording fees imposed by the state in which his land is located, his power to borrow on the security of land alone is limited in any case to 47½ per cent of its value; while his total liability, on account of the ownership of stock, may become 52½ per cent. If the experience of one of the so-called coöperative land credit companies now attempting to make loans in this manner in the Middle West may be taken as a reliable criterion, it will require no little effort to induce intelligent farmers to purchase stock, least of all to assume double liability on their shares.

Nor is the additional provision—that the commissions paid by federal land banks to agents or national farm loan associations be deducted from dividends on land bank stock—any material improvement over the present system so far as the actual method of granting loans is concerned. It is meant of course to prevent the payment of commissions in advance. But there are numerous sources from which borrowers can obtain loans up to 50 per cent of the value of cultivable land and, if the size or term of the loan is such as to call for the payment of a large commission, the agent will accept a second mortgage on the land in lieu of cash.

In the second place, no objection can be urged against the well meant purpose of the law in so far as it is designed to reduce the cost of borrowing by reducing administrative charges and by giving greater mobility to funds seeking farm mortgage investment. The present system of land credit is highly immobile. Owing to obnoxious state legislation, backward methods of farming, and the memory of the real estate collapse of the nineties, capital is still somewhat distrustful of land-mortgage security. Middlemen are everywhere required to direct a flow of capital to agricultural channels, and the machinery which they utilize to bring borrowers and lenders into contact with one another is altogether uneconomical and obsolete. This is especially true in the southern and western states where farmers are dependent on foreign capital. In North Dakota and Oklahoma, for instance, the average rate of interest received by 126 American life insurance companies in 1914 amounted to 5.88 and 5.91 respectively.[22] According to a recent estimate by the federal Department of Agriculture, the average annual commission paid by borrowers in those states amounts to 1.8 per cent.[23] Such charges add materially to the borrower's rate of interest. In the Eastern states, the commission charge is a less important element in the cost of borrowing because of the large supply of local capital.

The device to be employed in mobilizing land credit to better advantage is the farm loan bond. In principle, bonds issued on the collective security of farm mortgages are well adapted to this

[22] Report of Robert Lynn Cox at the Ninth Annual Meeting of the Association of Life Insurance Presidents as quoted in *Bulletin of the Farm Mortgage Bankers Association of America* (Chicago), Jan., 1916, p. 50.

[23] Testimony of C. W. Thompson showing the average annual commission by states, *Hearings before the Subcommittee of the Joint Committee on Rural Credits,* 64 Cong., 1 Sess., p. 98.

purpose. They ought, as in European countries, to be the means of drawing capital from centers where it is now redundant to those agricultural sections where the supply of local capital is inadequate. Moreover, within a given community they should make a large quantity of capital ordinarily diverted to other channels available for agricultural purposes. The only reason why such machinery has not been utilized more extensively in recent years by farm mortgage companies is because of the popular distrust manifested toward unregulated land-mortgage bond issues. Only a few of the strong companies whose reputation for integrity and conservatism is of the highest standing have been able to sell debenture bonds. Owing to the strict federal supervision that will be given to the land bank system, the difficulties that would otherwise be encountered in marketing land-mortgage bonds should be largely overcome.

The specific mechanism intended to reduce the administrative charge will vary in its effects according to the source of credit. In all cases the yearly charge for commission, which is included in the borrower's rate of interest, is limited to 1 per cent of the unpaid principal, and other charges made to borrowers on account of appraisal and the perfection of titles will be regulated by the Federal Farm Loan Board. When loans are granted by national farm loan associations or appointed agents of federal land banks, a commission charge of not more than one half per cent may be retained by the institution making the loan. The remainder will contribute to the profits of the federal land bank and may be partly recovered by borrowers in the form of dividends on stock. The significance of this arrangement is that those who borrow through national farm loan associations will pay the lowest possible administrative cost. They will share not only in the profits of a federal land bank, in common with those who borrow from appointed agents, but also in the profits of the association to which they belong. Borrowers from joint-stock land banks will recover no portion of the administrative charge unless of course they happen to be stockholders.

Manifestly the framers of the law cherished the hope that national farm loan associations would be immediately formed; and there is good reason to believe that many such associations will be organized in those communities where religious or communal bonds already exist. Others will undoubtedly follow as soon as the success of the initial organizations has been established. But

too much should not be expected of these associations. Farmers as a class are not possessed of a coöperative spirit. They have not yet reached the stage where they will care to have their personal affairs a matter of common knowledge. Nor has their time become so valueless that they can afford to devote it gratuitously to the organization and management of associations from which others will receive an equal benefit. Under these conditions it is not likely that the greater economies offered by the national farm loan association will be sufficiently attractive to *good* farmers to induce a majority of them to organize. Certainly, those who live in the newer sections of the country will prefer to borrow from agents of federal land banks or from institutions conducted solely for profit.

The position that joint-stock land banks will occupy in the new system is also a matter of some uncertainty. If formed, they should prove to be attractive sources of credit to those who prefer to deal with private institutions. Borrowers would not be obliged to purchase stock, to cultivate their mortgaged land, or to expend their loans for specific purposes. Nor would there be any restriction on the amount that might be loaned to a single individual. But in other respects, the law imposes such onerous restrictions on the powers of these banks as to discourage their formation. Why, for instance, should they not be allowed to operate in more than two states if they can do so with profit? It is a basic principle with those institutions that are noted for their conservatism in making farm loans to operate over an extended territory. The Pearsons-Taft Land Credit Company of Chicago has loans outstanding in sixteen states.[24] The Union Central Life Insurance Company of Cincinnati has gradually extended its farm loan territory until it now operates in thirty-four states.[25] Considerations of safety demand widespread investments. Similar considerations would demand that an institution having the power to issue farm loan bonds be allowed to make land-mortgage loans in several states. It is obvious, therefore, that the rigid limitation on the investment field of joint-stock land banks will not only detract from the security of their bonds but it may also prevent the large farm mortgage companies now operating over a wide territory from reorganizing under a federal charter.

[24] Testimony of M. J. Badow, *Joint Hearings before the Subcommittees of the Committees on Banking and Currency,* 63 Cong., 2 Sess., p. 587.

[25] *Annual Report,* Dec. 31, 1915, p. 5.

Another discomforting feature that will be prejudicial to the reorganization of farm mortgage companies is the requirement that loans made by joint-stock land banks must be approved by the Federal Farm Loan Board before they can be pledged as security for farm loan bonds. In practice this restriction could have but one effect: namely, that as a matter of prudence joint-stock banks would not make loans until they had first been approved by the federal authorities. And in the meantime borrowers might seek the prompt service accorded by other agencies.

It is extremely unfortunate, if private enterprise is to play a prominent role in the new system, that more leniency was not shown toward the joint-stock land banks. In other countries they have been found to be well adapted to the mobilization of land credit, and, although their earnings are not excessive,[26] capable of operating profitably in competition with coöperative and state aided ventures. These facts seem to have been appreciated only in part by the members of the Joint Committee on Rural Credits. For with a view to *equalizing* the profits that might be made by federal and joint-stock land banks they limited the bond issuing power of joint-stock banks to fifteen times their capital and surplus.[27] This action was in virtual recognition of the superior efficiency of private enterprise when given an equal opportunity. It is inconceivable why the opportunity should have been withheld.

A third purpose of the law is to mobilize land credit so effectually that interest rates on mortgage loans will be equalized. At present there is considerable variation in the farm-mortgage rate from one section of the country to another. Taking into account the average annual commission charge, which seldom amounts to more than 1 per cent, the farmer's rate of interest on mortgage loans is lowest in the New England and Middle Atlantic states varying from 5 to 6 per cent. In that portion of the North Central division which lies east of the 98th meridian, the rate varies from 6 to slightly over 7 per cent. Westward from this meridian the rate rises to 10 per cent, and then falls to approximately 8 per cent on the Pacific Coast. To the South of Penn-

[26] The most prominent institution of this kind in Germany is the Prussian Central Land Credit Joint Stock Company. The average dividend paid on share capital from the time of its formation in 1870 to 1913 was 9.3 per cent. *Cahill Report,* printed as Sen. Doc. No. 17, 63 Cong., 1 Sess., p. 74.

[27] See *Report of the Joint Committee on Rural Credits,* House Doc. No. 494, 64 Cong., 1 Sess., p. 14.

sylvania and the Ohio River, the rate gradually rises from 6 per cent in Maryland and 7 per cent in Kentucky to about 9 per cent in the Gulf States.[28]

The equalization of these various rates is expected to be a simple matter. Farm loan bonds will be well secured. Those issued by federal land banks will offer a number of attractive features not possessed by European land-mortgage bonds. To make certain that approximate uniformity in interest rates will be realized, the law fixes the maximum rate to be paid on bonds at 5 per cent and the highest rate, including commissions, to be paid by farmers at 6 per cent. As a precautionary provision, however, the limitation on interest rates is worse than useless. Either the rate paid by farmers in the South and West will be reduced to conform to the legal maximum or investors will be unwilling to purchase the bonds of land banks operating in those sections. In view of the abundant security offered by the bonds of federal land banks, the latter possibility seems doubtful.

The successful operation of the law, then, will result in the equalization of farm-mortgage rates. Farmers in the South and West with inferior security[29] will be able to borrow on as favorable terms as the farmers who live in the older agricultural sections. The demand for a material reduction in the current rate of interest will have been fully met. But in responding to this ubiquitous demand, there appears to have been no justification for drastic action. While it is true that the farmer's rate of interest is higher than the rate paid by *some* industrial and commercial corporations, the vendors of such comparisons forget that farming as a business is highly individualistic and is likely to remain so. If the farmer's rate of interest is excessive it is not because it is higher than the rate paid by corporate enterprises

[28] For average rates of interest and commissions by states, see testimony of C. W. Thompson, *Hearings before the Subcommittee of the Joint Committee on Rural Credits,* 64 Cong., 1 Sess., p. 98.

[29] Some would insist that their security is not inferior on the ground that the land is actually better in many cases than land in Iowa, Illinois, and Southern Wisconsin. But this point of view fails to take any account of the purpose for which land is used. Crops are the sustaining element in farm loans. Where one-crop systems are in vogue, land is highly speculative in value even though it is regularly cultivated. Until a more diversified culture has become prevalent in the South and West, farm lands in those sections will be inferior as security for mortgage loans no matter what system of land credit is adopted.

or by European farmers but because it is so much higher than the rate received by the ultimate lender. The difference represents the cost of mobilizing land credit under a wasteful and badly organized system. A more economical organization, rather than an approximate equalization of rates, should have been the goal of remedial legislation.

Serious consequences may follow if the set purpose of the law is fully realized. A material reduction in the current rate of interest, unaccompanied by careful restrictions on borrowing power, is opposed to the welfare of the tenant farmer who aspires to land ownership. The potential effect of lower rates is to promote the spirit of land speculation, raise the value of land and only further the movement toward concentration of ownership. These conditions, in turn, invariably breed farm tenancy and absentee landlordism. It is unfortunate that the present law takes so little account of such contingencies. It contains no definite restriction that will effectively prevent land speculation. Although the borrowers who depend upon the federal land bank system are required to engage in the cultivation of their mortgaged land and to expend their loans only for the most specific purposes, residence on the land is not made a condition of borrowing. Moreover, the maximum loan that can be granted to a single borrower seems much too large. It should at least have been limited to the amount necessary for the acquisition of a farm of profitable size—a farm that could be cultivated in a profitable manner by one operator. Finally, it should be remembered that not one of these restrictions is imposed on those who borrow from joint-stock land banks.

Perhaps a great deal will depend upon the course that is followed by the Federal Farm Loan Board in the interpretation of its powers, as to whether or not the land bank system will prove positively harmful. The law is ambiguous and indefinite on a number of points. It is not clear, for instance, whether the board has the power to regulate the rate of interest paid on farm loan bonds.[30] But it does have power to refuse to authorize any

[30] Section 16 provides that "joint stock land banks shall not be subject to the provisions of subsection (b) of section seventeen of this Act as to interest rates on mortgage loans or farm loan bonds." The subsection referred to gives the Federal Farm Loan Board power "to review and alter at its discretion the rate of interest to be charged by Federal land banks for loans made *by* (italics are the author's) them under the provisions of this Act, said

specific issue and it might exercise that power tacitly on the ground that the rate borne by the bonds was too high or that the underlying mortgages represented loans made for speculative purposes. If, therefore, the board places a liberal construction on its powers and, in coöperation with the land bank directors, rejects a large percentage of the applications for loans—as is the practice in New Zealand and Australia where systems of state loans are in force—the spirit of land speculation might be kept within present bounds. But the small borrower is the one who would suffer most from this policy because he is not usually possessed of unquestionable security. In either case the system would play into the hands of those landowners who are already prosperous.

On the whole, the law is a badly disguised attempt to establish a system of government loans, under the cloak of coöperation, where government loans are not needed. It is essentially a landowner's measure and one that will prove to be cumbersome and needlessly expensive in its operation. Federal land bank stock owned by the government will not share in dividend distributions; members of the Federal Farm Loan Board will receive an annual salary of $10,000 together with all necessary traveling expenses; the salaries of the twelve farm loan registrars, the numerous land bank examiners, the attorneys, experts, assistants, clerks, laborers and other employees required to conduct the business of the board will likewise be paid by the taxpayers. For the sake of simplicity and economy the problem of supplying landowners with adequate land credit facilities should have been left entirely to private initiative, subject in some measure to the same administrative authority that now supervises the national banking system. Or if a system

rates to be uniform so far as practicable." Nothing is contained in this subsection relative to the interest rate on bonds of federal land banks. But subsection (f) of the same section gives the board power "to prescribe the form and terms of farm loan bonds"; and section 20, dealing with the form of farm loan bonds, says "they shall have interest coupons attached, payable semi-annually, and shall be issued in series of not less than $50,000, the amount and terms to be fixed by the Federal Farm Loan Board." If by "terms" is meant the rate of interest, the law is contradictory. Such an interpretation would give the Federal Farm Loan Board power to regulate the rate of interest on bonds of joint-stock land banks, and section 16 would flatly deny that power. If the word "terms" is not meant to include the rate of interest, then a portion of section 16 is meaningless as it attempts to exempt joint-stock land banks from restrictions that are not imposed.

of government loans was regarded as the only *desirable* solution of the land credit problem, the so-called McCumber amendment which passed the Senate in February, 1915, might well have received more serious consideration. Although defective both in principle and purpose, it at least offered a plan having the combined merits of simplicity, economy, and certainty. It would have utilized to better advantage the institutions already in existence and, if found to be ill-adapted or grossly defective, could easily have been abandoned.

After all, there was no necessity for any kind of federal legislation affecting the land credit problem of landowners. That problem is of a comparatively simple nature and rightly belonged within the province of state legislation. There is, however, the more pressing problem of land credit with which the federal government should have been deeply concerned: namely, the problem of making the conditions of country life more attractive to the *younger* generation of farmers. In accomplishing this end some form of land purchase legislation is needed. In the long run no other course of action seems capable of checking the growth of tenancy and the depopulation of rural communities. Doubtless the framers of the present law were sincere in the belief that by applying one remedy to a two-fold problem these tendencies would be stayed. But in reality they seem only to have given a subsidy to present landowners, a subsidy that may aggravate rather than mitigate the problem of tenancy. It will now remain for the states to attack this important problem, as they have attacked others, by applying unlike remedies to a common ill when uniform treatment should be administered.

GEORGE E. PUTNAM.

University of Kansas.